

Projections of Returns to be Filed in Fiscal Years 1990-1997

By Marion W. Mak*

Fiscal year projections of the major types of returns provide a foundation for Internal Revenue Service (IRS) workload estimates, resource requirements, and budget submissions to the Treasury, Office of Management and Budget, and Congress. The most recent IRS projections indicate that a total of 202.8 million returns will be filed in Fiscal Year (FY) 1990, or an increase of 1.7 percent over the number of returns filed in FY 1989 [1]. Although projected year-to-year increases will range between 2 to 5 million returns, the yearly rates of growth in total filings are expected to decline from 2.6 percent in 1989 to 1.7 percent in 1997. Much of the year-to-year growth in total returns reflects the growth in individual returns, which make up more than half of the total returns.

Projections of returns are developed by: (1) using econometric models that relate the number of returns filed to selected independent economic and demographic variables and (2) extrapolating observed time trends into the projection period. The forecasting models are initially formulated on a calendar year basis. Fiscal year projections are derived from calendar year statistics by various methods including the seasonal adjustment method (see the section on Data Sources and Limitations).

The projections also include adjustments for the effects of recent legislative, regulatory and administrative changes. They generally do not anticipate legislative or administrative changes which are under consideration.

TOTAL PROJECTED RETURNS

The total number of returns, as shown in Table 1, Projection of the Number of Returns to be Filed with the Internal Revenue Service, Fiscal Years 1989-1997, is comprised of primary and supplemental returns. With few exceptions, items in both of these categories are a part of the IRS Master File system.

Primary returns are those that account for the majority of total filings and historically have generated the majority of the IRS document processing workload. These returns are expected to continue to account for the bulk of total filings throughout the forecast period.

Of the 194.3 million tax forms filed in 1988, 183.8 million were designated as primary returns. Major returns in the primary returns category include: U.S. Individual Income Tax Return; Individual Declaration of Estimated Tax; U.S. Corporation Income Tax Return; and Employer's Quarterly Federal Tax Return.

The number of information documents processed by the Service, such as interest and dividend statements and Forms W-2, Wage and Tax Statement, are not included in the returns counted or projected in this article because they are mostly filed on magnetic tape [2]. These returns are large in number so that, if included, they would increase the total number of returns substantially. In 1988, about 992 million information returns were processed by the Service. In 1989, the number is expected to exceed 1 billion.

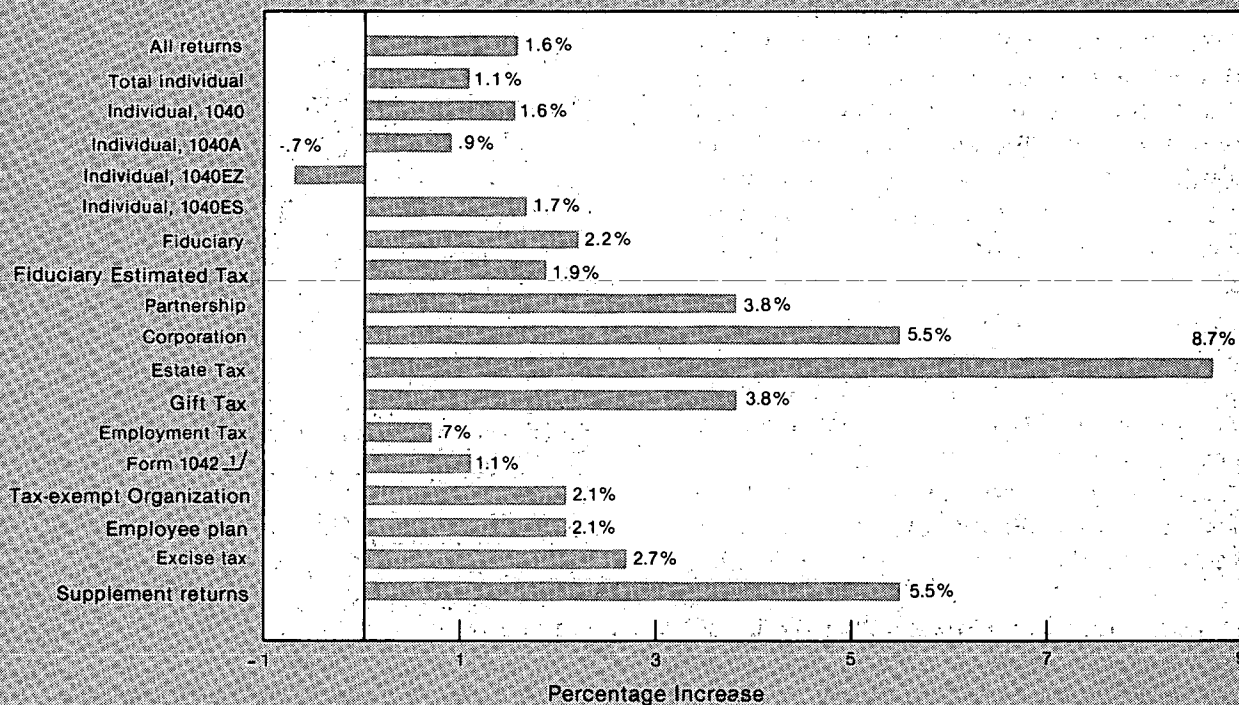
Figure A presents the average annual percentage changes for the major return types during the 1990-1997 projection period. Total returns increased by an average of 1.6 percent per year during this time frame. Projections for 1990 and the associated rates of change from 1989 to 1990 are presented in Figure B.

Individual Income Tax Returns

Important adjustments for recent legislation were made to the Form 1040, Form 1040A and Form 1040EZ returns projections. These return types will continue to be impacted in 1990 and subsequent years due to the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988.

*Statistician, Projections and Forecasting Group, Research Division.

Figure A.
**Projected Average Annual Percentage Change in the Number
 of Returns Filed, Fiscal Years 1990-1997**



^{1/}Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.

Figure B.—Projections for Fiscal Year 1990

Type of return	1990 Projection (thousands)	Percentage increase from 1989
Total returns	202,783	1.7
Primary returns, total	190,685	1.4
Individual income tax	111,487	1.4
Individual declaration of estimated tax	37,220	1.8
Fiduciary income tax	2,556	1.9
Fiduciary estimated tax	750	-1.2
Partnership	2,014	3.5
Corporation income tax	4,425	5.0
Estate and gift tax	166	4.4
Employment tax	28,680	.4
Form 1042 ¹	19	1.9
Tax exempt organization	524	4.4
Employee plan	1,910	2.5
Excise tax	934	-2.1
Supplemental returns	12,098	6.8

¹ Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.

The Tax Reform Act of 1986 is expected to result in a continued shift to simpler forms being filed in 1990. This shift is the result of such tax reform provisions as the repeal of the deduction for married couples when both work; the elimination of income averaging; limits on the use of (individual retirement arrangement (IRA) contributions to reduce "adjusted gross income"; and changes in the area of itemized deductions. The actual movement to simpler returns is also a function of taxpayers becoming more familiar with the effects of the law changes and realizing they can now use the shorter Forms 1040A or 1040EZ. An estimated 680,000 individual return filers are expected to shift to the simpler returns during the 1990 filing season. Though substantial, this shift is less than that which occurred in the prior 2 years under tax reform.

Growth in individual returns is dependent, in large part, on the growth of total employment. Current forecasts show the rate of employment growth slowing down throughout the 1989 to 1997 forecast period [3]. Total employment is projected to reach 119.4 million in Calendar Year 1989, a 1.9 percent increase over actual employment of 117.1 million in 1988. The rate of growth will gradually taper down to 1.3 percent by Calendar Year 1996. This slow-down in the rate of employment growth is mirrored in individual income tax return filings, so that a decline in the rate of growth of these filings is anticipated.

In addition, the growth in individual returns is expected to be further reduced in FY 1990 due to the effects of the 1988 Technical and Miscellaneous Revenue Act. Under this Act, parents may now elect to claim on their returns the unearned income of certain children. This law is effective for Tax Year 1989 returns and is expected to result in 570,000 fewer dependent filers in Fiscal Year 1990.

Figure C compares the number of Forms 1040, 1040A, 1040EZ, and total individual returns expected to be filed in 1990 and 1997, respectively.

Individual Declarations of Estimated Tax

Projections of Individual Declarations of Estimated Tax (Form 1040-ES "vouchers"--up to four per year can be filed) are developed from a regression of vouchers on the number of their taxpayer counterparts. The growth in Form 1040ES returns, therefore, is determined by the growth in individual returns. Current forecasts are calling for growth in Form 1040ES returns that ranges from 1.8 percent in 1990 to 1.6 percent in 1997.

Fiduciary Income Tax Returns

A provision in the Tax Reform Act of 1986 mandated that taxable trust filers of fiduciary income tax returns (Forms 1041), who previously could have filed on a noncalendar year basis, had to begin filing their returns on a calendar year basis. This resulted in a large one-time increase of 8.0 percent in Fiscal Year 1988 as noncalendar year filers adjusted their accounting periods to coincide with the calendar year by filing additional returns to cover transitional part year accounting periods. In 1989, as taxpayers return to their normal filing pattern, the number of returns to be filed is projected to show a substantial decrease of nearly 10 percent. After 1989, the yearly growth in returns is expected to be around 2.0 percent.

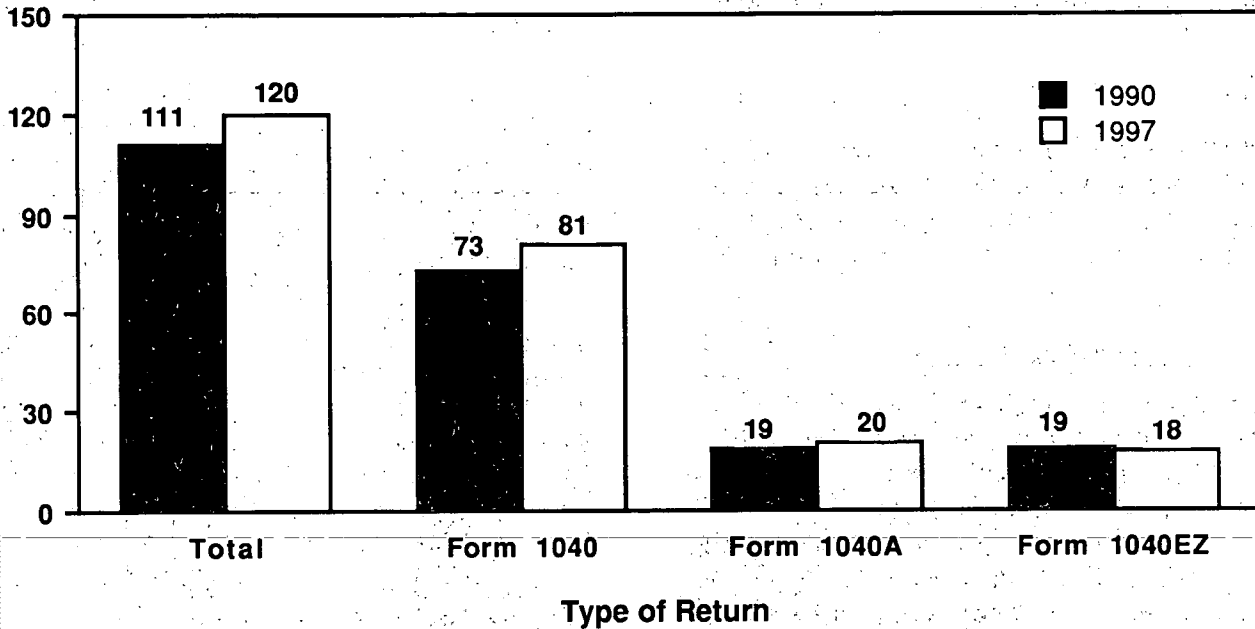
Fiduciary Estimated Tax Returns

The Tax Reform Act of 1986 required that both new and existing estates and trusts make estimated tax payments for the first time for calendar years beginning after 1986. Form 1041-ES, Estimated Income Tax for Fiduciaries, was developed for taxpayers with a tax liability of \$500 or more to compute and pay estimated taxes. Beginning with the quarterly estimated tax payments due September 18, 1988, the Service required financial institutions servicing 200 or more taxable trusts to remit payments through the Federal Tax Deposit (FTD) System by magnetic tape. Financial institutions servicing at least 50 taxable trusts can elect to file under the FTD Magnetic Tape Program. As a result of this procedure, the number of Form 1041-ES returns is expected to show a large decrease of 28.0 percent in FY 1989, and a smaller decrease of 1.2 percent in 1990. By 1997, a growth of 1.8 percent is expected.

Figure C

Individual Income Tax Returns by Type, Fiscal Years 1990 and 1997

Millions of Returns



Partnership Tax Returns

A provision in the Tax Reform Act of 1986 requiring that "passive losses" be offset only against "passive gains" resulted in fewer persons investing in these ventures [4]. As a result, there was a small decline in partnership returns in 1988. In 1989, the year-to-year growth was expected to reach 7.2 percent as investors adjusted their investment strategies to coincide with tax reform. Year-to-year increases from 1990 to 1997 will range from 3.5 percent to 5.0 percent.

Corporation Tax Returns

The Revenue Act of 1987 required that filers of "personal service" and S Corporation returns that wished to maintain the use of noncalendar year accounting periods estimate the amount of tax applicable to the deferral period--the period between the noncalendar year and the calendar year--and prepay this entire amount when filing the required excise tax return (see Excise Tax Returns, below) [5]. If the corporations decided to switch to a calendar year filing status in order to avoid this prepayment, they had to file twice during the year--the first to close

out the remainder of the noncalendar year and the second to end the calendar year. It is estimated that approximately 30,000 noncalendar or fiscal year filers will switch to filing a calendar year return. As a result, the number of corporation returns for 1989 is expected to increase by 5.7 percent. By 1990, the rate of increase will level off at 5.0 percent as a normal filing pattern is resumed.

Estate and Gift Tax Returns

The Tax Reform Act of 1976 and the Economic Recovery Act of 1981 both stipulated that the filing threshold for the U.S. Estate Tax Return (Form 706) be gradually increased on an annual basis, from \$60,000 for decedents who died in 1976 to \$600,000 for decedents who died in 1987 and beyond. Estate tax returns are projected to grow by only 3.6 percent in Filing Year 1989 as compared to 7.8 percent in 1990. The smaller growth in 1989 is mainly due to the impact of the raised filing threshold which should cause many small estates to stop filing. By 1997, the growth is expected to reach 8.7 percent. U.S. Gift Tax Returns (Forms 709) are projected to show a 2.2 percent growth in 1989, and a 2.5 percent growth in 1997.

Employment Tax Returns

Employment tax returns consist of Employer's Annual Federal Unemployment Tax Return, Employer's Annual/Quarterly Federal Tax Return, and Employer's Annual Railroad Retirement Tax Return. Projections for the forecast period 1990-1997 reflect year-to-year increases that average 0.7 percent per year.

Form 1042

Form 1042 is an annual withholding tax return filed for foreign "persons" with income from U.S. sources. Projections of Form 1042 returns are expected to increase by an average of 1.1 percent between 1990 and 1997.

Tax-Exempt Organization Returns

A host of tax-exempt entities, including those for public charities, farmers' cooperative associations, private foundations, and "other" exempt organizations, embody the exempt organization category of returns. The magnitude of this return category is dictated by changes in Form 990, Return of Organization Exempt From Income Tax (filed by the "other" organizations and by most public charities), which accounts for 78 percent of exempt organization filings. Current estimates of the year-to-year increase in tax exempt organizations are expected to range from 4.4 percent in 1990 to 1.5 percent in 1997.

Employee Plan Returns

The total for employee plan returns consists of the following: Form 5500, Annual Return/Report of Employee Benefit Plan; Form 5500C (same as the Form 5500 except that it is filed for plans with fewer than 100 participants); Form 5500EZ, Annual Return of One-Participant (Owners and Their Spouses) Benefit Plan; and Form 5500R, Registration Statement of Employee Benefit Plan (filed for plans with fewer than 100 participants). The projections are expected to show an increase of 2.5 percent in 1990 and 2.2 percent in 1997.

Excise Tax Returns

Total excise returns are the sum of the following returns: Form 11C, Special Tax Return and Application for Registry-Wagering; Form 720, Quarterly Federal Excise Tax Return; Form 730, Tax on Wagering; and Form 2290, Heavy Vehicle Use Tax Return. Two provisions of the Tax Reform Act of 1986

(modified by the Revenue Act of 1987) will continue to reduce the number of Form 720 returns filed to pay the excise taxes on gasoline and diesel fuel. The first provision requires that wholesalers pay the excise tax on diesel fuel rather than retailers. The second provision requires that the excise tax on gasoline be paid by the refiner, or first importer, rather than the wholesaler.

On the other hand, the implementation of a provision of the Revenue Act of 1987 partially offsets the decline in Form 720 returns filed. This provision specifies that all partnerships and S Corporations electing to maintain a noncalendar year reporting period must file Form 720 to make certain required payments. The net impact of these law changes on the filing of total excise tax returns is expected to be a 0.2 percent drop in returns in 1989 and a 2.1 percent drop in 1990. The balance of the forecast interval is expected to show a positive growth of 3.1 percent in 1991 and 2.7 percent in 1997.

Supplemental Documents

Supplemental documents are mainly composed of amended returns and requests for filing extensions from both individuals and corporations. Current forecasts of supplemental documents call for increases ranging from 6.8 percent in 1990 to 5.0 percent in 1997.

DATA SOURCES AND LIMITATIONS

The number of returns filed (as used in this article) represents returns processed at IRS service centers during a fiscal year [6]. The 1989 data for individual, estate, gift, employment, and excise tax returns were estimated by using actual returns processed through June 1989. The 1989 data for the rest of the forms are based on projections.

To illustrate the general forecasting process, projections for the combined total of Forms 1040, 1040A, and 1040EZ returns were developed based on a multiple regression relating total 1040 returns to total employment; an interaction variable involving both total employment and employed married women with husbands present (used as a proxy for potential joint filers); pension beneficiaries and annuitants; and qualitative "dummy" variables to account for the effects of law changes [7]. The historical base period for this regression was 1952-1989 with 1989 estimated on the basis of returns filed through June 1989. Return projections were primari-

ly formulated on a calendar year basis and subsequently converted to fiscal year projections by one of four methods. The method used most frequently employs the Census Bureau's X11-Q Seasonal Adjustment Program [8]. The method used second most frequently is to compute a ratio based on the quarterly filing experience of one or more historical years. The third method (used in instances where filing trends are not well defined) is based on assumed relationships between the number of returns and various filing patterns. The fourth method is a variation of the X-11Q approach in which the seasonal factors are subsequently trended.

NOTES AND REFERENCES

- [1] All statistics are for the years in which the tax returns were processed by the Internal Revenue Service, stated on a fiscal year (i.e., October through September) basis, unless otherwise noted. Actual counts for all of Fiscal Year 1989 were incomplete at the time this article was written (see the Data Sources and Limitations section). For complete counts, see U. S. Department of the Treasury, Internal Revenue Service, 1989 Annual Report, Commissioner and Chief Counsel, Internal Revenue Service, 1990.
- [2] Certain types of income tax returns are also either now being filed or will begin to be filed on magnetic tape during the projection period. However, it is expected that in most cases these returns will comprise a small proportion of the totals shown.

- [3] The largest component of total employment is represented by civilian employment, which was obtained from Data Resources, Inc. (DRI), in June 1989. DRI believes that employment growth will decline due to a general slowdown in economic activity through the mid-1990's.
- [4] Passive gains or losses resulted from trade or business activities in which the partners did not materially participate in the business on a regular, continuous, or substantial basis (i.e., they were "limited" partners). In general, as a result of the Tax Reform Act of 1986, such passive losses could not be deducted from other, non-passive, types of income.
- [5] In general, a "personal service" corporation is a company whose principal activity is personal service substantially performed by employee-owners who are shareholders at any time during the year. An S Corporation is a company with no more than 35 shareholders (who are individuals), electing to be taxed at the shareholder level.
- [6] U.S. Department of the Treasury, Internal Revenue Service, 1989 Annual Report, op. cit.
- [7] Projections of total employment, employed married women with husbands present, and pension beneficiaries and annuitants were made by the Projections and Forecasting Group, Research Division, Internal Revenue Service.
- [8] U.S. Department of Commerce, Bureau of the Census, "The X11-Q Variant of the Census Method II Seasonal Adjustment Program," Technical Paper No. 15 (1967 revision).

Table 1.—Projection of the Number of Returns to be Filed with the Internal Revenue Service, Fiscal Years 1989-1997

[Number of returns are in thousands]

Type of return	Actual 1988	Projected								
		1989	1990	1991	1992	1993	1994	1995	1996	1997
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Total returns ¹.....	194,305	199,328	202,783	205,195	208,744	212,407	215,712	219,278	223,076	226,842
Primary Total	183,781	187,997	190,685	192,393	195,159	198,024	200,550	203,312	206,281	209,217
Individual income tax, total	106,994	109,942 ²	111,487	111,997	113,405	114,866	116,033	117,373	118,834	120,222
Form 1040 series, total.....	106,764	109,693 ²	111,223	111,721	113,115	114,561	115,713	117,038	118,484	119,856
Form 1040.....	70,770	71,533 ²	72,793	73,582	75,049	76,527	77,427	78,615	79,896	81,119
Form 1040A.....	17,657	18,700 ²	19,125	19,203	19,357	19,398	19,768	20,011	20,283	20,353
Form 1040EZ.....	18,337	19,460 ²	19,305	18,936	18,709	18,636	18,518	18,412	18,304	18,384
Other ³	230	249 ²	264	276	290	305	320	335	350	366
Individual estimated tax.....	35,489	36,577	37,220	37,865	38,511	39,157	39,802	40,448	41,093	41,739
Fiduciary income tax ⁴	2,783	2,507	2,556	2,615	2,679	2,745	2,803	2,861	2,921	2,979
Fiduciary estimated tax.....	1,055	759	750	765	782	800	817	832	841	856
Partnership.....	1,814	1,946	2,014	2,033	2,109	2,219	2,294	2,379	2,492	2,615
Corporation income tax ⁵	3,986	4,213	4,425	4,612	4,852	5,133	5,415	5,721	6,064	6,440
Estate tax.....	52	54	58	63	69	75	82	89	96	105
Gift tax.....	103	105 ²	108	113	118	123	128	132	136	140
Employment tax ⁶	28,218	28,555 ²	28,680	28,855	29,079	29,274	29,467	29,690	29,935	30,165
Form 1042 ⁷	17	18 ²	19	19	19	19	19	20	20	20
Tax-exempt organization ⁸	490	502	524	540	554	566	577	587	596	605
Employee plans ⁹	1,819	1,864	1,910	1,953	1,994	2,036	2,075	2,115	2,158	2,206
Excise ¹⁰	956	954 ²	934	962	988	1,010	1,036	1,065	1,096	1,125
Supplemental documents	10,524	11,331	12,098	12,802	13,584	14,383	15,162	15,967	16,795	17,625
Form 1040X.....	1,559	1,649	1,769	1,875	1,993	2,117	2,238	2,363	2,494	2,625
Form 4868.....	5,563	6,049	6,486	6,872	7,324	7,790	8,244	8,720	9,215	9,713
Form 2688.....	1,484	1,680	1,787	1,873	1,967	2,059	2,143	2,227	2,311	2,392
Form 1120X.....	51	43	36	32	30	28	27	26	25	24
Form 7004.....	1,836	1,881	1,990	2,118	2,238	2,357	2,477	2,596	2,715	2,835
Form 1041A.....	31	30	31	31	32	33	34	34	35	36

¹ Included in the total are the following "Non-master File" returns: Form CT-2, 941M, 990BL and 1120-IC-DISC for FY 1988; projections of these forms for future years have been discontinued and are therefore not shown below.

² Projection is based on returns processed through June 1989.

³ Includes Forms 1040NR, 1040 PR, 1040SS, and 1040C; Form 1040X is included under Supplemental Documents, below.

⁴ Includes Forms 1041 and 1041S; Form 1041A is included under Supplemental Documents, below.

⁵ Includes Forms 1120, 1120A, 1120F, 1120H, 1120L, 1120M, 1120POL, 1120S, 1120DF, 1120SFC, 1120PC, 1120EIT, and 1120 FIC; Form 1120X is included under Supplemental Documents, below.

⁶ Includes Forms 940, 940EZ, 940PR, 941, 941E, 941PR, 941SS, 942, 942PR, 943, 943PR, and CT-1.

⁷ Annual Withholding Tax Return for U.S. Source income of Foreign Persons.

⁸ Includes Forms 990, 990C, 990PF, 990T, 4720, and 5227.

⁹ Includes Forms 5500, 5500C, 5500EZ and 5500R.

¹⁰ Includes Forms 11C, 720, 730 and 2290; excludes Forms 11 and 5000.24 which are filed with the Bureau of Alcohol, Tobacco and Firearms, U.S. Department of the Treasury, instead of with the Internal Revenue Service.

NOTE: Detail may not add to totals because of rounding.